

August 8, 2011

Via Facsimile and Overnight Mail

Emily S. McMahon  
Acting Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Re: Gift Tax and Section 501(c)(4) Organizations

Dear Ms. McMahon:

I am writing on behalf of four clients, who wish to remain anonymous, to request that guidance be immediately issued with regard to the application of the federal gift tax to gifts to organizations recognized as exempt from federal income tax under section 501(c)(4) of the Internal Revenue Code of 1986. The reason for this request, and the sense of urgency behind it, is to resolve confusion created by a publicly-released memorandum issued by the Deputy Commissioner for Services and Enforcement of the Internal Revenue Service ("IRS") on July 7, 2011. In the July 7 memorandum, a copy of which is enclosed, the Deputy Commissioner directed that five on-going examinations of individuals who had made contributions to one or more organizations exempt under section 501(c)(4) be closed and that all enforcement activity involving the application of the gift tax to such contributions be suspended. The memorandum itself did not provide a legal rationale for its directives, however, it did indicate that the Deputy Commissioner's Office would be coordinating with the Office of Chief Counsel "to determine whether there is a need for further guidance in this area." The memorandum further noted that the application of the gift tax to gifts to section 501(c)(4) organizations is a "difficult area with significant legal, administrative, and policy implications with respect to which we [IRS] have little enforcement history." For the reasons set forth below, my clients request that the Treasury Department issue guidance that clearly indicates whether or not the gift tax applies to gifts to section 501(c)(4) organizations, so that all taxpayers, not just the five individuals who were the beneficiaries of the July 7 memorandum, may have assurance as to the scope of the gift tax. If you conclude that the gift tax does apply to such gifts, then it is imperative that the guidance be issued immediately and that an appropriate investigation be undertaken to ensure that the July 7 memorandum was not the result of improper political influence.

The confusion and the need for immediate guidance arise from the fact that, contrary to the implications of the July 7 memorandum, the official IRS position on the application of the gift tax to gifts to section 501(c)(4) organizations was clear until the July 7 memorandum was issued, and taxpayers could arrange their affairs accordingly. Setting aside the question of whether the application of the tax to such gifts might be vulnerable in litigation, the clear IRS enforcement position is reflected in *Blaine v. Comm'r*, 22 T.C. 1195 (1954), in which the Tax Court held that the gift tax applies to gifts to section 501(c)(4) organizations, two earlier decisions in which courts supported the imposition of the gift tax on gifts to lobbying organizations<sup>1</sup> and Revenue Ruling 82-216, 1982-2 C.B. 220. Revenue Ruling 82-216 was issued in the wake of two appellate court decisions declining to apply the gift tax to gifts to political organizations in years before the enactment of section 2501(a)(5), which exempts gifts to political organizations from the gift tax. Noting that Congress had enacted only two exemptions from the gift tax – for gifts to charities and to political organizations – Rev. Rul. 82-216 states that the IRS “continues to maintain that gratuitous transfers to persons other than [charitable or political organizations] are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor’s own social, political, or charitable goals.” 1982-2 C.B. at 221. As you are aware, revenue rulings reflect official tax policy and are reviewed and approved by both the IRS and by Treasury. They are published “to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose.”<sup>2</sup>

The July 7 memorandum observes that “questions have been raised regarding the application of the gift tax to contributions to I.R.C. § 501(c)(4) organizations.” What the memorandum leaves out is that the questions were publicly raised by six Republican members of the Senate Finance Committee and by the Republican Chair of the House Ways & Means Committee. My clients are concerned because it seems apparent from the narrow, partisan, source of the public Congressional protestations of the IRS audits that the five donors may likely have also been significant donors to Republican causes. The immediate benefit to those donors from the summary termination of their audits, without any guidance being provided to other, similarly situated, taxpayers suggests a politically-motivated action by the IRS, if only in the form of a misguided effort to avoid controversy. My clients are concerned about the intentions of the IRS on the issue, if it arises in the context of taxpayers who do not have the same access to influential members of Congress. The clear implication left by the IRS action on July 7 is that IRS enforcement activity can be curtailed by intervention from a handful of members of Congress, whatever their party affiliation, when political contributions are at risk. My clients are also deeply concerned about the attendant corrosive impact that the July 7 memorandum will have on voluntary compliance with federal tax laws, given the partisan context in which it was issued and the absence of clear legal justification.

By suspending enforcement activity pending the possible issuance of guidance of an unspecified nature and conclusion, the July 7 memorandum puts taxpayers considering gifts to section 501(c)(4) organizations involved in the development of public policy in the difficult position of not knowing whether to pay gift tax or not, or whether to file claims for refunds of gift taxes paid, effectively chilling the speech rights of the donors. Meanwhile, the five

<sup>1</sup> *Faulkner v. Commissioner*, 41 B.T.A. 875 (1940), *Dupont v. United States*, 97 F. Supp. 944 (D. Del. 1951).

<sup>2</sup> Treas. Reg. § 601.601(d)(2)(v)(d).

individuals whose examinations were closed, and those individuals alone, now have protection from further IRS review of their questioned gifts by virtue of IRS Policy Statement 4-3, which generally proscribes the reopening of closed examinations.

The July 7 memorandum also presented IRS Counsel with the Hobson's choice of summarily reversing the 1982 revenue ruling and abandoning the IRS victory in *Blaine*, together with its predecessors, in order to provide *post hoc* justification for the July 7 action, without there having been an intervening change in the law, or confirming the continuing validity of the 1982 revenue ruling and the *Blaine* decision, an action which would reinforce the questionable appropriateness of the July 7 decision. Finally, because enforcement activity was suspended without a change in the existing precedential guidance on the application of the gift tax, tax practitioners are presented with the conundrum of having to advise clients with regard to the gift tax based, in part, on the chances of an IRS audit, an action prohibited by Section 10.37(a) of Circular 230, which provides rules for practice before the IRS.

To summarize, my clients are concerned as to whether it is the official position of the government that the gift tax applies to gifts to section 501(c)(4) organizations, as a general rule, or whether it does not. While my clients understand that the IRS may revisit its interpretation of the tax laws from time to time, they are very concerned about the circumstances surrounding the recent pronouncements by the IRS and request that the Treasury Department expeditiously address the confusion and concern arising from the July 7 memorandum. They are particularly concerned, in view of the general state of political discourse, over indications that the decision to terminate the audits and suspend further enforcement action was motivated by concerns regarding the political implications of the decision, rather than by an allegiance to nonpartisan application of the tax laws.

If you, or your staff, have any questions for my clients, please direct them to me. I will coordinate with them, as appropriate, in order to preserve their anonymity.

Sincerely,

A handwritten signature in black ink, appearing to read 'MSO', with a long horizontal flourish extending to the right.

Marcus S. Owens

Enclosure



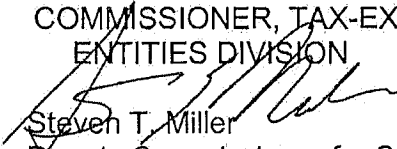
DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

July 7, 2011

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, TAX-EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

FROM:

  
Steven T. Miller  
Deputy Commissioner for Services and Enforcement

SUBJECT:

Guidance for SB/SE Estate and Gift Tax and TE/GE Exempt  
Organizations

Questions have been raised regarding the application of gift tax to contributions to I.R.C. § 501(c)(4) organizations. This is a difficult area with significant legal, administrative, and policy implications with respect to which we have little enforcement history. My office will be coordinating with the Office of Chief Counsel to determine whether there is a need for further guidance in this area.

Until further notice, examination resources should not be expended on this issue. It is anticipated that any future examination activity would be after the coordination described above and would be prospective only after notice to the public. Thus, the Service should not expend examination resources initiating referrals or developing audits. Accordingly, all current examinations relating to the application of gift tax to contributions to I.R.C. § 501(c)(4) organizations should be closed. This directive reaffirms and expands the suspension on March 23, 2011, of such examinations by SB/SE Estate and Gift.

This directive has no impact on any decision to pursue, or on the scope of, any examination of I.R.C. §§ 501(c) and 527 organizations, including the correct application of the tax under I.R.C. § 527(f). Nor does this directive have any impact on other estate or gift tax examinations that do not involve the issue of whether gift tax applies to contributions to I.R.C. § 501(c)(4) organizations.

cc: Chief Counsel